Internal Revenue Service

memorandum

CC:TL:TS
JHELKE

date: AUG 6 1987

to: Special Trial Attorney, North Atlantic

from: Director, Tax Litigation Division CC:TL

subject: Request for Technical Advice - [redacted]

Issue

Whether the petitioner qualifies as dealer for purposes of section 108 of the Tax Reform Act of 1984 as amended by section 1808(d) of the Tax Reform Act of 1986 (hereinafter section 108)?

Conclusion

We agree with your opinion that petitioner's commodity futures activities are not sufficiently continuous or regular to qualify petitioner as being in a trade or business for purposes of being treated as a dealer under section 108.

Facts

In [redacted], petitioner was employed as chemist with [redacted]. In connection therewith, he received W-2 wages which he reported on his return. In addition, petitioner claimed to maintain a business as an investment advisor and for the year [redacted] claimed a net profit in the amount of approximately $[redacted]. In addition to the foregoing, in [redacted], petitioner engaged in commoditiy futures trading in a diversified group of futures including gold, silver, copper, pork bellies, cattle, hogs, sugar, soybeans, wheat and corn. He executed approximately [redacted] trades, all of which were straddles. Short-term capital losses of approximately $[redacted] resulted.

In [redacted], petitioner ceased working full time for [redacted] and concentrated on his investment advisor and commodity futures contract trading activities. As in [redacted], petitioner continued his commodity futures trading in a diversified group of futures contracts and executed over [redacted] trades, all straddles. Additional losses in the amount of approximately $[redacted] occured.

There have been no facts establishing stating that the petitioner:

1. maintained an inventory of contracts with the hope of reselling to other customers;

2. purchased contracts directly to sell to customers and sold property desired by customers;

3. made a market in a particular commodity contract;

4. acted as agent or broker and earned ordinary income from brokerage commissions;

5. held himself out to the public as dealer; or

6. had used and qualified under the self-employment tax provisions of the Code.

Law and Analysis

Section 108(b) sets forth a per se profit motivation rule which was enacted to protect purported dealers in their straddle transactions. Section 108 of Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494, 630 provided in part:

> SEC. 108 TREATMENT OF CERTAIN LOSSES ON STRADDLES ENTERED INTO BEFORE EFFECTIVE DATE OF ECONOMIC RECOVERY TAX ACT OF 1981.
>
> (A) GENERAL RULE - For purposes of the Internal Revenue Code of 1954 in the case of any disposition of which one or more positions - (1) which are entered into before 1982 and form part of the straddle, and (2) to which the amendments made by Title V of the Economic Recovery Tax Act of 1981 do not apply, any loss from such disposition shall be allowed for the taxable year of the disposition if such position is part of a transaction entered into for profit.
>
> (B) PRESUMPTION THAT TRANSACTION ENTERED INTO FOR PROFIT - For purposes of subsection (a), any position held by commodities dealer or any person regularly engaged in investing in regulated futures contracts shall be rebuttably presumed to be part of a transaction entered into for profit.

Section 1808(d) of the Tax Reform Act of 1986 made technical corrections to section 108, in part, as follows: (Pub. L. No. 99-514, 100 Stat. 2817)

(d) Section 108 of the Tax Reform Act of 1984 is amended - (1) by striking out "if such position is part of a transaction entered into for profit" and inserting in lieu thereof (if such loss is incurred in a trade or business, or if such loss is incurred in a transaction entered into for profit though not connected with a trade or business.) (2) by striking out subsection (b) and inserting in lieu thereof the following:

"(b) LOSS INCURRED IN A TRADE OR BUSINESS. - For purposes of subsection (a) any loss incurred by a commodities dealer in the trading of commodities shall be treated as loss incurred in a trade or business."

The legislative history of the 1986 Act states, in part, that "the bill makes clear that subsection (b) treatment is limited to those taxpayers in the business of trading commodities. The determination of whether a taxpayer is in the business of trading commodities is based upon all the relevant facts and circumstances." H. Rep. No. 99-426, 99th Cong., 1st Sess. 911 (1985).

In Commissioner v. Groetzinger, __U.S. ___ 87-1 USTC ¶ 9191 (Feb. 24, 1987), the Supreme Court reviewed the cases related to the definition of a trade or business and held that Mr. Groetzinger, a full-time gambler, was engaged in a trade or business. In its analysis, the Court stated that to be engaged in a trade or business, a taxpayer must be involved in that activity with continuity and regularity and the primary purpose for engaging in the activity must be for income and profit. The Court commented favorably on Higgins v. Commissioner, 312 U.S. 212 (1941), where the Court upheld the government's position that an investor, who merely engaged in personal investment activities, was not engaged in a trade or business.

Recently in Beals v. Commissioner, T.C. Memo. 1987-171 (March 30, 1987), the Tax Court reviewed the situation where the petitioner managed the investments owned by him, by his wife, and by three of his children. The petitioner followed closely the management and performance of the companies in which they held stock and was not compensated by his family for managing their accounts. The question for the Court's decision was whether the petitioner was engaged in a trade or business for purposes of the maximum tax provided by section 1348 of The Code. The Tax Court, after reviewing the cases in the area concluded that, even though the petitioner was not a mere passive investor and actively

investigated and followed the investments made by him and his family, it was still well settled that the management of investments, despite the extent and scope of such activity, is not a trade or business for tax purposes.

We note that the six factors enumerated earlier regarding "dealer" activities were not part of [redacted]'s so-called business.

Accordingly, we agree with your position and conclude that [redacted] is not a dealer for purposes of the per se rule under section 108(b).

You have informed us that the second part of your inquiry has been withdrawn since the case has settled. We hope this response will assist you as you develop other cases in the area.

If you have any further questions on this, call Joel Helke at FTS 566-4369.

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